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SUMMARY

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DEVELOPMENT BANKS

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DEVELOPMENT BANKS

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SUMMARY

1. As used in this paper development banks are autonomous financing institutions organized in developing countries with assistance from foreign lending agencies for the purpose of lending to or otherwise investing in economically desirable projects in the private sector. The number of such institutions has increased steadily in the past several years. A properly organized and managed development bank can serve as a powerful financial force for encouraging economic change and new attitudes toward business.

2. Such institutions are ideally suited to the policies and operational procedures of foreign sources of financing. They are in a good position to receive foreign assistance which is convenient for both the donor and the recipient country. They can be an important stimulant for new investment and for new jobs. They can help create a vigorous class of local entrepreneurs and investors. They can become self-supporting institutions performing functions so important in the economy that they become points of stability in the society because their valuable work must continue despite changes in government.

3. A development bank or a similar development institution is essentially a device to fill a gap in the existing financial structure of a country. There appear to be needs for several kinds of development banks--broadly defined. One kind consists of those sponsored by the World Bank and other official lending agencies in countries where entrepreneurs and investors exist in sufficient numbers and kind to respond actively when financing and technical assistance are made available on reasonable terms. A second kind would be those in situations where there are few entrepreneurs, where the market is small, and where there is not likely to be any significant short-term response to increased credit availability alone. This kind of institution is perhaps more nearly an investment company than a lending institution and fills the function of the entrepreneur.

4. The needs for development financing institutions vary country by country and the form must be tailored to each situation. In many countries the ideal set of development financing institutions might include both a government-owned and a privately-owned development bank which can complement each other's activities. Other circumstances favor a mixed institution in which the government participates financially, but which is controlled by private ownership.

1/ Mr. Checchi has directed a number of studies on this subject

There are distinct advantages in early government financial support which may be necessary to the viability of the institution and which may provide some restraint on private management to protect the institution from serving only special private financial interests.

5. One of the most important initial tasks for a new development bank will be to establish satisfactory relations with other important agencies with which it must work. Foremost among these are international lending agencies, foreign private capital markets, local banks, local government economic planning agencies, and others. Development banks can provide four main types of services: financial services, financial agency services, entrepreneurial services, and technical assistance services.

6. In one situation the primary need may be for a bank simply to administer loans. Elsewhere the need may be to provide its technical assistance services linked to credit to make the credit effective. In another situation, the entrepreneurial services of the bank linked to credit may be of vital importance. A well managed bank which exercises appropriate control on the enterprises it finances to protect the interests of minority stockholders will generate the kind of public confidence in equity securities which might otherwise be impossible to achieve.

7. A most difficult problem facing development banks in many countries is the viability of the bank in its early years of operation. Most banks are faced with a heavy initial investment in operating personnel and thus high operating costs relative to lending volume. Some of the foreign assistance agencies have provided various forms of subsidies to enable a development bank to weather the difficult early years and establish itself as a generator of capital and an energizing force for a growing economy.

8. A second major problem area which faces the international lending agencies which sponsor development banks involves the danger of monopoly. The dangers inherent in a single development bank is that it may fall under the control of a small special interest group. In addition, its management, free from any of the influences of competition in a country, may acquire that kind of arrogance which makes it impossible for it to recognize a mistake. A third, and perhaps the most important problem is the shortage of management skill and experience in the field of development lending.

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